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No. 06-989

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

HALL STREET ASSOCIATES, L.L.C.,
Petitioner,

v.

MATTEL, INC.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF FOR THE PETITIONER

MICHAEL T. GARONE *
MICHAEL A. COHEN
JAY T. WALDRON
SARA KOBAK
SCHWABE, WILLIAMSON & WYATT, P.C.
1211 SW Fifth Ave., Suites 1600-1900
Portland, OR 97204-3795
(503) 222-9981

* Counsel of Record — *Counsel for Petitioner*

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTION PRESENTED

Did the Ninth Circuit Court of Appeals err when it held, in conflict with several other federal Courts of Appeals, that the Federal Arbitration Act ("FAA") precludes a federal court from enforcing the parties' clearly expressed agreement providing for more expansive judicial review of an arbitration award than the narrow standard of review otherwise provided for in the FAA?

LIST OF PARTIES TO THE PROCEEDINGS

Petitioner Hall Street Associates, L.L.C., was the plaintiff in the district court and cross-appellant/appellee in the Ninth Circuit Court of Appeals.

Mattel, Inc., Tyco Industries, Inc., Tyco Manufacturing Corp., Tyco Toys, Inc., and View-Master Ideal Group, Inc. were defendants in the district court. Mattel, Inc. was appellant/cross-appellee in the Ninth Circuit Court of Appeals. The other defendants were not parties in the Ninth Circuit Court of Appeals.

Petitioner Hall Street Associates, L.L.C. previously filed a corporate disclosure statement pursuant to Rule 29.6 with the petition for writ of certiorari. No amendments to the prior statement are necessary at this time.

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BRIEF FOR THE PETITIONER

Hall Street Associates, L.L.C. ("Petitioner" or "Hall Street") respectfully requests that this Court reverse the judgment of the United States Court of Appeals for the Ninth Circuit and remand the case to the Ninth Circuit with instructions to enforce the judicial review provision in the parties' arbitration agreement.

OPINIONS BELOW

The decisions of the United States District Court for the District of Oregon, and the decisions of the United States Court of Appeals for the Ninth Circuit, in this case are

unreported. (Pet. App. 39a-58a; 117a-128a; Jt. App. 140-142; 155-158.)[1]

JURISDICTION

The Ninth Circuit entered its most recent decision in this case on August 1, 2006. The Ninth Circuit denied a timely petition for rehearing en banc on October 17, 2006. The petition for writ of certiorari was filed on January 12, 2007, and was granted on May 29, 2007. This Court has jurisdiction under 28 U.S.C. § 1254(1).

RELEVANT STATUTORY PROVISIONS INVOLVED

The appendix to Hall Street's Petition for Writ of Certiorari contains the relevant statutory provisions, namely, 9 U.S.C. §§ 2, 9, 10, and 11. (Pet. App. 1a-3a.)

STATEMENT OF THE CASE

Since the enactment of the Federal Arbitration Act ("FAA") in 1925, the use of arbitration has become increasingly common, benefiting litigants by providing a mechanism for efficient and expeditious resolution of disputes and benefiting the judiciary by lessening its burden. Notwithstanding those benefits, many parties are reluctant to use arbitration—particularly in commercial disputes of any monetary significance—due to concerns about reliability and adherence to the law in the arbitral decision-making process.

The parties to this case shared those concerns. To address them, the parties, in the middle of on-going litigation in federal court, agreed to arbitrate a portion of the issues in their case on the condition that the federal court retained authority to review the arbitral decision for legal error. The question in this case is whether the Ninth Circuit erred in

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[1] The Appendix filed by Petitioner Hall Street with its petition for writ of certiorari is referred to herein as "Pet. App." The Joint Appendix filed with this merits brief is cited as "Jt. App."

refusing to enforce the terms of the parties' agreement providing for judicial review of the arbitration award for legal error. Because the FAA does not prevent courts from enforcing arbitration agreements stipulating to judicial review for legal error, Hall Street asks this Court to reverse the decision of the Ninth Circuit invalidating the judicial review provision in the parties' arbitration agreement.

A. Factual Background

This case stems from a property lease dispute between Hall Street and Respondent Mattel, Inc. ("Mattel"). Starting in 1981, Mattel and its predecessors leased property from Hall Street on which Mattel and its predecessors operated a toy manufacturing facility. (Pet. App. 18a.) The lease between Mattel and Hall Street contained no agreement to arbitrate disputes. Instead, the lease preserved both parties' right to have all claims arising under the lease resolved by court adjudication. (Jt. App. 73-114.)

Section 12(a) of the parties' lease required Mattel to comply with all federal, state, and local environmental laws and regulations in its use of the leased property. (Jt. App. 85.) Among other applicable laws, an Oregon state law—namely, the Oregon Drinking Water Quality Act, OR. REV. STAT. § 448.114 *et seq.* —required Mattel to regularly test the well water on the leased property for environmental contaminates.

Although its employees regularly used the well water on the leased property for drinking and bathing, Mattel and its predecessors failed to comply with the testing requirements of the Oregon Drinking Water Quality Act during the approximately 18 years that they occupied the property. (Pet. App. 26a, 52a, 81a.) After Hall Street commissioned environmental consultants to test the well water on the property in 1998, Hall Street discovered that the well water was contaminated with trichloroethylene ("TCE") in concentrations significantly above federal limits. (Pet. App. 26a-27a.)

On February 10, 2000, Hall Street filed a complaint in Oregon state court seeking injunctive and declaratory relief, as well as monetary damages, for Mattel's breach of the parties' lease agreement. (Dist. Ct. Docket No. 1.) Mattel removed the case to the United States District Court for the District of Oregon based on the diversity of the parties. (*Id.*)

In the district court, the parties conducted a court trial on one issue in the case involving Mattel's termination of the lease. After the district court decided that issue—and after a subsequent unsuccessful attempt to settle the entire case through mediation—the parties proposed to the district court to arbitrate the remaining issues in the case. (Jt. App. 46.) The proposed arbitration agreement allowed either party to seek district court review of the arbitral decision for substantial evidence and errors of law. (Pet. App. 8a, 46a.)

At the time the parties made their proposal to arbitrate, the parties and the district court were bound by the decision of the Ninth Circuit in *LaPine Tech. Corp. v. Kyocera Corp.*, 130 F.3d 884 (9th Cir. 1997), *vacated sub nom. Kyocera Corp. v. Prudential-Bache T Services, Inc.*, 341 F.3d 987 (9th Cir. 2003) (en banc) *petition for cert. dismissed*, 124 S. Ct. 980 (2004). In *LaPine*, the Ninth Circuit held that nothing in the FAA precludes parties from agreeing to deviate from the statutory grounds for vacatur and agreeing to allow federal courts to review an arbitration award for legal error. Based on *LaPine*, the district court approved the parties' agreement to arbitrate the remaining issues and agreed to confirm the arbitration award only if it was free from legal error. (Pet. App. 8a, 46a.)

B. The Arbitration Agreement

The parties' arbitration agreement contained several provisions relating to the district court's review of the arbitration award. First, to facilitate that review, Paragraph 1 of the arbitration agreement specified that the "arbitrator shall

prepare written findings of fact and conclusions of law that may be reviewed" by the district court at the request of either party. (Pet. App. 5a.) The arbitration agreement also specified the standard of review of the arbitration award:

> The arbitrator shall decide the matters submitted based upon the evidence presented and the applicable law. The arbitrator shall issue a written decision which shall state the basis of the decision and include specific findings of fact and conclusions of law. The United States District Court for the District of Oregon may enter judgment upon any award, either by confirming the award, or by vacating, modifying or correcting the award. *The Court shall vacate, modify or correct any award: (i) where the arbitrator's findings of facts are not supported by substantial evidence, or (ii) where the arbitrator's conclusions of law are erroneous.*

(Pet. App. 16a) (emphasis added).

The paragraph of the arbitration agreement entitled "Confirmation of Award by Judgment" conditioned confirmation of the arbitral decision on the district court first reviewing the arbitration award for substantial evidence or legal error at the request of either party. (Pet. App. 15a.)

The judicial review provision was crucial to the parties' willingness to arbitrate the remainder of their dispute because of the high stakes at issue in the case.[2] (Jt. App. 52.) Following the district court's approval of the agreement, the parties proceeded to arbitration to resolve the remaining issues in the case.

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[2] In an affidavit to the district court on Hall Street's motion for review of the arbitration award for legal error, Hall Street's trial attorney averred that the judicial review provision was "[o]ne of the primary features of this arbitration agreement." (Jt. App. 52.)

C. Procedural History

1. *The Original Arbitration Decision*

In January 2002, the arbitrator issued his "Findings of Fact and Conclusions of Law." (Pet. App. 17a-38a.) The arbitrator determined that Mattel's predecessor, View-Master, was "the only party with intimate knowledge of the property" when the parties negotiated the lease and that the lease therefore contained a broad indemnification clause that required Mattel to "indemnify Hall Street for all activities with respect to the premises whether or not they occurred before the date of the original lease." (Pet. App. 19a.) The arbitrator further concluded that the lease imposed liability on Mattel for the presence of hazardous waste on the property irrespective of the time when the presence or use of the hazardous waste occurred. (Pet. App. 35a.) The arbitrator determined that the "only exception" to the indemnity obligation was if Mattel: (1) complied with all applicable federal, state, and local environmental laws; and (2) did not directly or indirectly contribute to the presence or use of hazardous waste on the property. (*Id.*)

In his findings of fact, the arbitrator found that Mattel and its predecessor had failed to comply with the testing requirements of the Oregon Drinking Water Quality Act during the approximately 18 years that they occupied the property. (Pet. App. 26a.) Notwithstanding that factual finding, however, the arbitrator concluded that Mattel's admitted failure to comply with the Oregon Drinking Water Quality Act was not a violation of any "applicable environmental law" under the lease. According to the arbitrator, the Oregon Drinking Water Quality Act was not an "applicable environmental law" because the statute sought to protect human health and was "not designed to protect landowners from having their property protected from environmental contamination." (Pet. App. 35a-36a.) The arbitrator determined that Mattel's failure to comply with Oregon water testing requirements "may

constitute a violation of other laws, but does not constitute a violation of 'applicable environmental laws' regarding TCE." (*Id.*) Based on that conclusion, the arbitrator ruled that Mattel was entitled to the contractual exception to the broad indemnification requirements of the lease. (*Id.*)

2. *The District Court's Review of the Arbitrator's Original Decision and the Subsequent Arbitration Decision*

After the arbitrator issued his decision concluding that Mattel had no indemnification obligations, Hall Street filed a motion with the district court seeking review of the arbitrator's decision. (Pet. App. 40a.) Mattel also filed a "contingent appeal" with the district court. (Pet. App. 56a.) Both parties sought judicial review in accordance with the standard of review set forth in their arbitration agreement and approved by the district court. In its motion, Hall Street did not contest any factual findings of the arbitrator, arguing instead that the arbitrator had committed legal error in concluding that Mattel's admitted violation of the Oregon Drinking Water Quality Act was not a violation of an "applicable environmental law." (Pet. App. 51a.)

After briefing and argument by both parties, the district court granted Hall Street's motion to vacate and remanded the matter to the arbitrator for further consideration. (Pet. App. 51a.) Relying on the arbitrator's factual finding that Mattel and its predecessors had failed to test for TCE contamination on the property for a period of approximately 18 years, the district court adopted the arbitrator's legal conclusion that Mattel had violated the Oregon Drinking Water Quality Act. (Pet. App. 42a-43a, 52a.) The district court also adopted the arbitrator's legal conclusion that the lease was "written to impose broad liability on the tenant for any environmental damage on the property" unless Mattel "was in compliance with all 'applicable environmental laws.'" (Pet. App. 53a.)

After agreeing with those legal conclusions, however, the district court parted ways with the arbitrator. Specifically, the district court held that the arbitrator erred in concluding that the Oregon Drinking Water Quality Act is not an "applicable environmental law." (Pet. App. 53a.) The district court explained:

> The arbitrator's contrary reasoning—that Oregon's Drinking Water Quality Act ("ODWQA") does not constitute "applicable environmental laws" because "these health provisions are designed to protect a specific type of injury, *i.e.*, health injury to people from drinking the water, and are not designed to protect landowners from having their property protected from environmental contamination"—is an overly restrictive construction of "applicable environmental laws." * * * *No* environmental statute advances such a purpose; the *purpose* of such statutes is to protect the environment and human health.

(Pet. App. 53a-55a (emphasis in original).) The district court went on to state that the arbitrator's conclusion that the Oregon Drinking Water Quality Act is not an applicable environmental statute "defies logic" and remanded the matter to the arbitrator. (Pet. App. 55a.)

On remand, the arbitrator entered an amended decision based on the district court's ruling that the Oregon Drinking Water Quality Act qualified as an applicable environmental law. (Pet. App. 81a.) Based on his conclusion that Mattel had violated the law, the arbitrator ruled that no exceptions to Mattel's indemnification agreement applied. (*Id.*) As a result of that conclusion, the arbitrator rendered a decision in favor of Hall Street in the amount of $583,971.60. The arbitrator also awarded declaratory relief against Mattel for all future costs that Hall Street might be required to pay relating to the environmental cleanup of the property. (Pet. App. 85a.) The

arbitrator then rendered a supplemental decision awarding attorney fees and costs to Hall Street. (Jt. App. 70-72.)

Both Hall Street and Mattel filed motions with the district court seeking review of the arbitrator's amended decisions. (Pet. App. 87a.) Again, both parties sought review in accordance with the standard of review agreed to by the parties in their arbitration agreement and approved by the district court. (Pet. App. 89-90a, 98a.) Other than correcting the arbitrator's computation of prejudgment interest, the district court upheld the arbitrator's amended award. (Pet. App. 95a, 110a.) On May 14, 2003, the district court issued a judgment incorporating both the court's initial decision regarding the lease termination issue (which had been tried before the court) and the arbitrator's amended award in favor of Hall Street. (Pet. App. 111a-113a.) The money judgment in Hall Street's favor amounted to $810,107.49, with six percent (6%) post-judgment interest. (*Id.*)

3. *The Decision of the Ninth Circuit on Enforceability of the Parties' Judicial Review Provision*

Both sides appealed to the Ninth Circuit from certain aspects of the district court's judgment. Notably, in the time between the district court's approval of the parties' arbitration agreement and the filing of the parties' appeals from the district court's judgment, the Ninth Circuit reversed its decision in *LaPine* holding that the FAA's statutory grounds for modification or vacatur of an arbitral decision were not exclusive. In *Kyocera Corp. v. Prudential-Bache T Services, Inc.*, 341 F.3d 987 (2003) (en banc), *petition for cert. dismissed*, 124 S. Ct. 980 (2004), the Ninth Circuit concluded that the FAA precluded parties from modifying the statutory grounds for vacatur of arbitral awards to authorize judicial review of an arbitration award for legal error. *Id.* at 1000.

Based on its decision in *Kyocera*, the Ninth Circuit reversed the district court's judgment in this case, stating in

an unpublished opinion that "*Kyocera* compels us to vacate the district court's judgment based on the arbitration agreement and remand to the district court." (Jt. App. 141.) Again relying on *Kyocera*, the Ninth Circuit also held that "the terms of an arbitration agreement controlling the mode of judicial review are unenforceable and severable." (*Id.*) In remanding the case, the Ninth Circuit instructed the district court to confirm the arbitrator's initial award in favor of Mattel "unless the district court determines that the award should be vacated on the grounds allowable under 9 U.S.C. § 10, or modified or corrected under the grounds allowable under 9 U.S.C. § 11." (Jt. App. 142.)

4. *The District Court's Decision on Remand and Subsequent Appeal*

On remand, the district court held that grounds for vacating the arbitrator's award existed under 9 U.S.C. section 10. (Pet. App. 117a-128a.) Relying on the decisions of the Ninth Circuit in *Theis Research Inc. v. Brown & Bain*, 386 F.3d 1180, 1185 (9th Cir. 2004), *amended on denial of rehearing*, 400 F.3d 659 (9th Cir. 2005), *cert. denied*, 126 S. Ct. 1429 (2006), and *Employer's Insurance of Wausau v. National Union Fire Insurance Co. of Pittsburgh*, 933 F.2d 1481 (9th Cir. 1991), the district court concluded that an arbitrator exceeds his or her powers within the meaning of 9 U.S.C. section 10 when the arbitral award is based on an "implausible interpretation of a contract." (Pet. App. 124a.) Noting that neither party seriously disputed that the Oregon Drinking Water Quality Act was an environmental law or that Mattel had violated it, the district court determined that nothing in the lease supported the arbitrator's conclusion that the phrase "applicable environmental laws" meant "anything other than its plain meaning, *i.e.*, the body of environmental law that generally applies to Mattel and with which Mattel's non-compliance could expose Mattel or Hall Street to civil or criminal penalties." (Pet. App. 125a-126a.) Based on its

conclusion that the arbitrator's decision resulted from an implausible interpretation of the parties' lease, the district court again vacated the original arbitration award, granted Hall Street additional attorney fees and costs, and again entered judgment in favor of Hall Street. (Pet. App. 127a-128a.)

Mattel appealed to the Ninth Circuit. On August 1, 2006, a majority of a panel of the Ninth Circuit reversed the district court's judgment, holding that "[i]mplausibility is not a valid ground for avoiding an arbitration award under either 9 U.S.C. §§ 10 or 11." (Jt. App. 156.) In doing so, the panel majority explained that, "[a]lthough the arbitrator's assessment of the merits in this case contains possible errors of law, those errors are not a sufficient basis for a federal court to overrule an arbitration award." (*Id.*) Despite its acknowledgement of possible errors of law, the panel majority held that the arbitrator's decision was not "completely irrational," which it recognized as a valid nonstatutory basis for vacating an arbitration award under the FAA. (Jt. App. 157.) The panel majority remanded the case to the district court with instructions to enforce the original arbitration award and to declare Mattel the prevailing party. (*Id.*)

Judge Susan Graber dissented on the ground that the arbitrator's award was "completely irrational." (*Id.*) She stated that "the only rational reading" of the term "applicable environmental laws" was "all federal, state, and local environmental laws and regulations" which Mattel was required to comply with in its use of the premises. (*Id.*) Because no reasonable dispute existed that the Oregon Drinking Water Quality Act was an applicable environmental law that Mattel had violated, Judge Graber would have either upheld the district court under the "completely irrational" standard or remanded the case to the district court for reconsideration under that standard. (Jt. App. 158.)

Hall Street sought en banc review of the decision. The Ninth Circuit denied that request by order on October 17,

2006. (Pet. App. 138a.) Hall Street then filed a timely petition for a writ of certiorari with this Court, asking for review of the legal issue whether the FAA prohibited parties to an arbitration agreement from agreeing to judicial review of an arbitration award beyond the grounds set forth in the FAA. On May 29, 2007, this Court granted Hall Street's petition.

SUMMARY OF THE ARGUMENT

Sections 10 and 11 of the Federal Arbitration Act ("FAA") provide procedural mechanisms for parties to an arbitration agreement to petition a federal court for vacatur or modification of an arbitration award. 9 U.S.C. §§ 10, 11. The question in this case is whether sections 10 and 11 prescribe the exclusive grounds upon which a federal court may vacate or modify an arbitration award, or whether the FAA permits parties to stipulate to vacatur or modification of an arbitration award for legal error.

An examination of the FAA, this Court's case law, and the legislative history of the statute provides a clear answer to that question: The FAA does not prevent enforcement of an arbitration provision clearly and unambiguously stipulating to judicial review of an arbitration award for legal error because such a provision furthers the goals and policies of the FAA and is consistent with the court's normal judicial functions.

The primary purpose of the FAA is to ensure that "private agreements to arbitrate are enforced according to their terms." *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989). Section 2 of the FAA imposes a presumption of enforceability of arbitration agreements, providing that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. In view of that broad mandate, this Court repeatedly has held that private agreements to arbitrate must be rigorously enforced according to their terms, even if those

terms deviate from the FAA's statutory provisions. *See, e.g., Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985); *Volt Info. Sciences*, 489 U.S. at 479.

Nothing in the FAA suggests that any different rule should apply to the FAA's judicial review provisions. Section 9 of the FAA authorizes "parties in their agreement" to determine whether "a judgment of the court shall be entered upon the award made pursuant to the arbitration[.]" 9 U.S.C. § 9. By deferring to the parties' agreement on whether a judgment shall be entered, section 9 necessarily allows parties to specify in their agreement the circumstances under which a judgment shall not be entered on an arbitration award. Those circumstances may include conditions on court confirmation of an award which are different than the statutory grounds for vacatur or modification under sections 10 or 11. Parties who stipulate to judicial review for legal error agree to court confirmation of the arbitration award only if the award is free from legal error, and nothing in the text or structure of the FAA prevents parties from striking such a bargain.

This Court's case law confirms that view. As an initial matter, this Court itself implicitly has recognized that sections 10 and 11 do not prescribe the exclusive grounds for vacatur or modification of an arbitration award because this Court has approved other judicially-created exceptions to confirmation of arbitration awards. *See, e.g., Wilko v. Swan*, 346 U.S. 427, 436 (1953) (manifest disregard of the law), *overruled on other grounds by Rodriquez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989). Moreover, this Court repeatedly has instructed that the FAA permits parties to specify their own procedural rules for arbitration, even if those rules alter the role of the court set out in the FAA itself. *See, e.g., Volt Info. Sciences*, 489 U.S. at 476 ("There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements

to arbitrate."); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) (parties may agree to have arbitrator decide arbitrability of dispute). Those decisions establish that litigants may agree to vary or supplement the provisions of the FAA—including provisions relating to the role of the courts—so long as their stipulated procedures do not do "violence to the policies behind the FAA," *Volt Info. Sciences*, 489 U.S. at 479, and are consistent with the court's normal judicial functions.

An arbitration agreement, entered into in the middle of ongoing federal litigation, which clearly and unmistakably preserves the court's ability to correct an arbitrator's erroneous legal conclusion, does not offend the goals and policies of the FAA or unduly burden the federal judiciary. The legal error review provision in the parties' arbitration agreement has clear precedents in federal jurisprudence. Review for legal error is among the normal judicial functions of the federal district courts. District courts regularly review for legal error in court adjudications when litigants object to magistrate decisions, *see* FED. R. CIV. P. 72(b), or when litigants consent to the appointment of a special master, *see* FED. R. CIV. P. 53(g). District courts also review for legal error in the context of bankruptcy proceedings. *See, e.g.*, 28 U.S.C. § 157(c)(1) (so providing). Thus, the legal error review provision in the parties' arbitration agreement invokes a familiar role for the courts.

The parties' arbitration agreement in this case also did not usurp any congressional power or dictate to the court how to conduct its judicial proceedings. To the contrary, the district court fully endorsed the parties' agreement and entered it as an order of the court. Nor did the parties' agreement purport to confer federal jurisdiction. It is well-settled that the FAA is not a jurisdictional statute and that any case before a federal district court under the FAA must have an independent jurisdictional basis. *Moses H. Cone Mem'l Hosp. v.*

Mercury Constr. Corp., 460 U.S. 1, 25 n. 32 (1983). In this case, no question exists that the district court possessed jurisdictional authority to resolve the parties' dispute. Indeed, the district court decided one aspect of the case before the parties agreed to arbitrate the remaining issues. If the parties to this case had not entered into their arbitration agreement, the district court would have been required to preside over the entire proceeding and dispose of all issues in the case. By submitting part of their case to arbitration, the parties reduced—rather than increased—the burden of the district court by eliminating the need for plenary adjudication in favor of a more limited judicial review.

Consistent with the purpose of the FAA and this Court's precedents, numerous lower courts have held that the statutory grounds for vacatur and modification of arbitrations awards in sections 10 and 11 of the FAA are not exclusive. Those courts allow parties to supplement those provisions by clear and unambiguous agreement so long as the stipulated procedures are consistent with the goals and policies of the FAA and are consistent with the court's normal judicial functions. *See, e.g., Roadway Package Sys. Inc. v. Kayser*, 257 F.3d 287, 292-93 (3d Cir.), *cert. denied*, 534 U.S. 1020 (2001); *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*, 64 F.3d 993, 997 (5th Cir. 1995). In doing so, those courts recognize that the FAA does not preclude parties from "opt[ing] out of the FAA's off-the-rack vacatur standards and fashion[ing] their own [standards]." *Roadway Package Sys. Inc.*, 257 F.3d at 293.

Finally, the policies of the FAA favoring arbitration and the enforcement of arbitration agreements according to their terms supports the view that the FAA permits parties to contract for judicial review of arbitration awards for legal error. "Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit." *Volt Info. Sciences*,

489 U.S. at 479. Allowing parties the freedom to stipulate to judicial review for legal error promotes arbitration by appealing to parties who otherwise would be reluctant to arbitrate for fear of a legally erroneous award without a chance for meaningful review. Although permitting parties to make such stipulations may require courts, on occasion, to engage in a more searching inquiry than the limited grounds for review under the FAA, those agreements nevertheless will reduce the burden on the judiciary by increasing the number of parties willing to participate in arbitration, particularly in commercial disputes of monetary significance. Taken together with the express terms of the statute and this Court's case law, those considerations confirm the enforceability of arbitration agreements providing for judicial review of arbitration awards for legal error.

ARGUMENT

Similar to other provisions in the Federal Arbitration Act ("FAA"), the statutory provisions for judicial review of arbitration awards under the FAA are not exclusive. Instead, parties may supplement those provisions by clear and unambiguous agreement so long as their stipulated procedures do not frustrate the goals and policies of the FAA and are consistent with the court's normal judicial functions. Because arbitration provisions providing for judicial review of arbitration awards for legal error are consistent with the goals and policies of the FAA and employ a standard of review which district courts regularly apply in a variety of contexts, those provisions are entitled to enforcement under the FAA.

I. THE FAA SUPPORTS ENFORCEMENT OF THE PARTIES' AGREEMENT STIPULATING TO JUDICIAL REVIEW FOR LEGAL ERROR

In *Kyocera Corp. v. Prudential-Bache T Services, Inc.*, 341 F.3d 987 (9th Cir. 2003) (en banc), *petition for cert. dis-*

missed, 124 S. Ct. 980 (2004), the Ninth Circuit concluded that sections 10 and 11 of the FAA prescribe the exclusive grounds for vacatur or modification of an arbitration award, explaining that "because Congress has specified standards for confirming an arbitration award, federal courts must act pursuant to those standards and no others." *Id.* at 1000. The Ninth Circuit's conclusion finds no support in the FAA.

Passage of the FAA "was motivated, first and foremost, by a congressional desire to enforce [arbitration] agreements into which parties had entered." *Dean Witter Reynolds Inc. v. Bryd*, 470 U.S. 213, 220 (1985). In view of that overriding purpose, this Court repeatedly has held that the FAA permits parties to specify their own procedural rules for arbitration, even if those rules deviate from the procedural rules set out in the FAA itself. *See, e.g., Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 486, 476 (1989) ("There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate."). Nothing in the text or history of the FAA suggests that any different rule applies to the FAA's judicial review provisions. The Ninth Circuit's contrary conclusion requires reversal.

A. Overview of the FAA

The FAA was enacted in 1925, 43 Stat. 883, and then reenacted and codified in 1947 as Title 9 of the United States Code. *See Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991) (noting same). The Act's "purpose was to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements upon the same footing as other contracts." *Id.*

To promote the enforcement of arbitration agreements, the FAA first declares that written agreements to arbitrate "shall

be valid, irrevocable, and enforceable." 9 U.S.C. § 2. The FAA then confers federal courts with specific authority to enforce arbitration agreements. Among other things, the FAA authorizes federal courts to: (1) stay litigation until the arbitration has been conducted "in accordance with the terms of the [parties' arbitration] agreement," 9 U.S.C. § 3; (2) compel parties to submit to arbitration "in accordance with the terms of the agreement," 9 U.S.C. § 4; (3) appoint neutral arbitrators, 9 U.S.C. § 5; and (4) compel appearances of witnesses at arbitration hearings, 9 U.S.C. § 7.

The FAA also confers federal courts with authority to review arbitration awards. If the parties authorize the court to do so in their agreement, a district court may confirm and enter a judgment on an arbitration award. 9 U.S.C. § 9. In addition, a party to an arbitration agreement may petition a district court for vacatur or modification of an arbitration award. Section 10 of the FAA states that the district court "may" vacate an arbitration award when: (1) the arbitration award was procured by corruption, fraud, or undue influence; (2) evidence exists of partiality or corruption among the arbitrators; (3) the arbitrators committed misconduct prejudicing the rights of a party; or (4) the arbitrators exceeded their powers. 9 U.S.C. § 10. Section 11 authorizes modification of the arbitration award when: (1) the award contains evident material miscalculations of figures or mistakes in descriptions of persons, things, or property; (2) the arbitrators have issued an award on a matter not submitted to them; or (3) the award is imperfect in its form. 9 U.S.C. § 11.

As explained below, an examination of sections 10 and 11 in their statutory context makes clear that those provisions are not the exclusive grounds upon which a district court may vacate or modify an arbitration award. Instead, parties may supplement those provisions by express agreement so long as their stipulated procedures do not frustrate the goals and

policies of the FAA and are consistent with the court's normal judicial functions.

B. Sections 10 and 11, Viewed in Context of the FAA as a Whole, Support the Enforcement of Arbitration Provisions Stipulating to Judicial Review for Legal Error

The text of the FAA is silent on the question of whether its statutory provisions—including the provisions for vacatur and modification of arbitration awards under sections 10 and 11—may be varied by private contract. When sections 10 and 11 are viewed in the broader context of the FAA as a whole, however, it is clear that those provisions—like other provisions in the FAA—are not intended to limit parties' ability to contract for specific arbitration procedures. *See Robinson v. Shell Oil Co.*, 519 U.S. 337, 345-46 (1997) (statutory text must be construed in view of "the specific context in which that language is used, and the broader context of the statute as a whole"). *See also Volt Info. Sciences*, 489 U.S. at 479 (parties may "specify by contract the rules under which [their] arbitration will be conducted"). Instead, in deciding the enforceability of judicial review provisions supplementing sections 10 and 11, the proper inquiry is whether the particular agreement at issue "undermine[s] the goals and policies of the FAA," *Volt Info. Sciences*, 489 U.S. at 478, and prescribes a procedure that is consistent with the court's normal judicial functions. Because arbitration provisions stipulating to judicial review for legal error satisfy those standards, such provisions are enforceable under the FAA.

1. *Sections 10 and 11 Do Not Prohibit Parties from Stipulating to Judicial Review of Arbitral Decisions for Legal Error*

Sections 10 and 11 of the FAA set out limited grounds upon which a court may vacate or modify an arbitration

award. Three out of the four statutory grounds for vacatur under section 10 relate to defects in the arbitration process itself, such as fraud, corruption, or misconduct by the arbitrators. 9 U.S.C. § 10(a)(1)-(3). The fourth statutory ground for vacatur arises when the arbitrator exceeds his or her power, or so imperfectly executes it that no "mutual, final, and definite award" was made. 9 U.S.C. § 10(a)(4). The statutory grounds for modification of an arbitration award under section 11 are similarly narrow, authorizing courts to correct certain errors unrelated to the merits of an arbitration award. 9 U.S.C. § 11.

On their faces, sections 10 and 11 do not prohibit parties from supplementing those statutory grounds for vacatur or modification of arbitration awards by stipulating to judicial review for legal error. No evidence exists that Congress intended to limit the ability of private parties to stipulate to judicial review for legal error. Indeed, when sections 10 and 11 are viewed in the context of the FAA as a whole, it appears that Congress intended the opposite.

This Court has held that statutory ambiguities should be resolved in a manner consistent with the primary purpose of the statute. *Robinson*, 519 U.S. at 346. *See also Burlington N. & Santa Fe Ry. Co. v. White*, 126 S. Ct. 2405, 2412 (2006) (same). Any ambiguity in sections 10 and 11 therefore must be resolved with due regard for the mandate of section 2 – the FAA's primary substantive provision – and the FAA's primary purpose: to enforce arbitration agreements according to their terms. *See Volt Info. Sciences*, 489 U.S. at 478-79 (stating that "Congress' principal purpose" in enacting the FAA was "ensuring that private agreements to arbitrate are enforced according to their terms"). As described in more detail below, the context of the FAA as a whole does not support interpreting sections 10 and 11 as prescribing the exclusive grounds for vacatur and modification of arbitration awards under the FAA.

2. *Section 2 is the Primary Substantive Provision of the FAA and Strongly Supports Enforcement of the Parties' Judicial Review Provision.*

Section 2 of the FAA provides that a "written provision . . . to settle by arbitration" a controversy arising out of "a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Section 2 is the "primary substantive provision" of the FAA, *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). It is the FAA's "centerpiece provision," *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985), and it establishes a "broad principle of enforceability" of arbitration agreements. *Southland Corp. v. Keating*, 465 U.S. 1, 11 (1984).

Although "generally applicable contract defenses, such as fraud, duress, or unconscionability" apply equally to arbitration agreements, *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996), section 2 mandates that agreements to arbitrate otherwise must be "rigorously enforce[d]." *Byrd*, 470 U.S. at 221. *See also Mitsubishi Motors Corp.*, 473 U.S. at 625 ("The 'liberal federal policy favoring arbitration agreements,' . . . manifested by [section 2] and the Act as a whole, is at bottom a policy guaranteeing the [illegible] of private contractual arrangements [to arbitrate] [illegible] *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24). Indeed, this Court has described the enforcement of arbitration agreements "according to their terms" as the "central purpose" of the FAA. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995) (internal quotation marks and citations omitted).

The "broad principle of enforceability" manifested by section 2 provides strong contextual support for the view that sections 10 and 11 are standards for judicial review which

parties are free to supplement with judicial review provisions that are consistent with the court's normal judicial functions. Nothing in section 2—or any other provision of the FAA—suggests that Congress contemplated an exception to the "broad principle of enforceability" for arbitration agreements allowing judicial review for legal error. Instead, because legal error is an ordinary standard of judicial review which courts are accustomed to applying and which is well within the scope of a court's normal judicial functions, the mandate of section 2 strongly suggests that such provisions should be enforced.[3]

3. *Section 9 of the FAA Supports Enforcement of the Parties' Judicial Review Provision*

The statutory provisions providing for judicial review of arbitration awards also support the view that the FAA does not prescribe the exclusive grounds for vacatur or modification of arbitration awards. Section 9 of the FAA is the statutory provision which authorizes district courts to confirm

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[3] The legislative history of the FAA confirms that Congress sought to ensure enforcement of arbitration agreements in passing that statute. The initial House Report on the FAA describes the comprehensive objective of the Act as "to make valid and enforcible [*sic*] agreements for arbitration. . . ." H. R. REP. NO. 68-96, at 1 (1924). The initial Senate Report similarly emphasized the "practical justice in the enforced arbitration of disputes where written agreements for that purpose have been voluntarily and solemnly entered into." S. REP. NO. 68-536, at 3 (1924). *See also* James M. Gaitis, *Unraveling the Mystery of Wilko v. Swan: American Arbitration Vacatur Law and the Accidental Demise of Party Autonomy*, 7 PEPP. DISP. RESOL. L.J. 1, 48 (2007) ("There is nothing in the legislative history of the FAA to suggest that, in addition to the primary policy objective of the enforcement of agreements to arbitrate, the FAA promoted an utterly contradictory exception to that policy whereby any contractual expectation that an arbitral tribunal would correctly apply the law would be deemed unenforceable under the FAA." (emphasis omitted)).

and enter judgments on arbitration awards. That provision provides, in part:

> If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title * * *

9 U.S.C. § 9.

Section 9 prescribes that the court has authority to enter judgment on an arbitration award only if the parties have conferred that authority upon the Court in their arbitration agreement. By giving parties the power to determine whether a court may enter judgment on an arbitration award, section 9 necessarily confers parties with the authority to determine the circumstances under which a court may not enter judgment on an award. The authority vested in the parties by section 9 gives parties the freedom to deviate from the statutory grounds for vacatur or modification under sections 10 or 11 and to determine by individual contract the prerequisites for confirmation of an arbitration award. Since the court's authority to enter judgment derives exclusively from the parties' agreement, parties may expressly agree, just as the parties did in this case, that a court will not enter judgment on an award based on erroneous conclusions of law. *See* Lee Goldman, *Contractually Expanded Review of Arbitration Awards*, 8 HARV. NEGOTIATION L. REV. 171, 181 (2003) (arguing that parties who agree to judicial review provisions do "not agree to court confirmation unless supported under the standard provided for in the agreement").

Although parties obviously may not impose prerequisites to confirmation that would require courts to deviate from

their normal judicial functions, the text of section 9 signals that the standards for judicial review of arbitration awards under sections 10 and 11 of the FAA are not exclusive and may be supplemented by agreement of the parties. In this case, Hall Street and Mattel agreed in their arbitration agreement that the court had authority to confirm and enter judgment on the arbitration award only if the award was not based on erroneous conclusions of law. (Pet. App. 15a-16a.) Because the legal error standard of review at issue in this case is a standard that is consistent with normal judicial functions and the policies of the FAA, review for legal error is a permissible prerequisite to confirmation of the arbitration award under section 9.

C. This Court Implicitly Has Recognized that the FAA Does Not Prescribe the Exclusive Grounds for Vacatur or Modification of Arbitration Awards

This Court's case law implicitly recognizes that sections 10 and 11 do not prescribe the exclusive grounds for vacatur or modification of an arbitration award. Both this Court and the lower federal courts long have recognized the existence of numerous non-statutory standards of review that apply in reviewing arbitration awards under the FAA. Among other formulations not found in the statute's text, courts have refused to confirm an arbitration award where the award is in "manifest disregard of the law," "violates public policy," is "arbitrary or capricious," or is "completely irrational." *See, e.g.*, *Wilko v. Swan*, 346 U.S. 427, 436 (1953) (manifest disregard of the law), *overruled on other grounds by Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989); *W.R. Grace & Co. v. Local Union 759*, 461 U.S. 757, 766 (1983) (violates public policy); *Brown v. ITT Consumer Fin. Corp.*, 211 F.3d 1217, 1223 (11th Cir. 2000) (arbitrary and capricious); *French v. Merrill Lynch, Pierce, Fenner & Smith*, 784 F.2d 902, 906 (9th Cir. 1986) (completely

irrational); *Hoffman v. Cargill, Inc.*, 236 F.3d 458, 462 (8th Cir. 2001) (award may be vacated if "not susceptible of the arbitrator's interpretation"); *Bull HN Info. Sys., Inc. v. Hutson*, 229 F.3d 321, 331 (1st Cir. 2000) (award may be vacated if contrary to the "plain language" of the contract). None of those judicially-created grounds for vacatur is set forth in section 10. The proliferation of these non-statutory, judicially-created grounds for vacatur illustrates that the vacatur standards of section 10 are not exclusive.

D. This Court Has Interpreted Other Provisions of the FAA As Default Provisions Which Parties May Supplement by Agreement

This Court's interpretation of other provisions of the FAA provides further contextual support for the view that sections 10 and 11 of the FAA do not prescribe the exclusive grounds for vacatur or modification of arbitration awards. Indeed, this Court repeatedly has instructed that parties are not bound by the procedural rules in the FAA and, instead, are free to fashion their own procedural rules for arbitration. As this Court explained in *Volt*, preventing "the enforcement of agreements to arbitrate under different rules than those set forth" in the FAA "would be quite inimical to the FAA's primary purpose of ensuring that private agreements to arbitrate are enforced according to their terms." 489 U.S. at 478-79.

Several decisions illustrate that point. In *Volt*, the parties' construction contract contained an agreement to arbitrate all disputes arising out of the contract. The contract also contained a choice-of-law clause providing that "[t]he Contract shall be governed by the law of the place where the Project is located," in that case, California. *Id.* at 470. California law permitted a court to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it. *Id.* at 471.

The FAA contains no provision permitting a court to stay arbitration pending resolution of related litigation involving third parties. Indeed, the FAA provides exactly the opposite. Section 3 of the FAA provides that any suits or proceedings brought "upon any issue referable to arbitration" shall be stayed pending arbitration. 9 U.S.C. § 3. Section 4 of the FAA also entitles a party as a matter of right to an order compelling arbitration. 9 U.S.C. § 4.

The appellant in *Volt* argued that sections 3 and 4 of the FAA did not allow application of California law to permit a stay of the arbitration. *Id.* at 476-77. In addressing that argument, this Court first noted that "[t]he FAA contains no express preemptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration." *Id.* at 477. This Court then examined whether application of the conflicting California law "would undermine the goals and policies of the FAA." *Id.* at 478. This Court concluded that it would not, explaining:

> In recognition of Congress' principal purpose of ensuring that private arbitration agreements are enforced according to their terms, we have held that the FAA preempts state laws which require a judicial forum for the resolution of claims which the contracting parties agree to resolve by arbitration. *But it does not follow that the FAA prevents the enforcement of agreements to arbitrate under different rules than those set forth in the Act itself.* Indeed, such a result would be quite inimical to the FAA's primary purpose of ensuring that private agreements to arbitrate are enforced according to their terms. *Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit.* Just as they may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted.

Id. at 478-79 (internal citations and quotations omitted; emphasis added).

This Court in *Volt* held that the parties' agreement to "abide by state rules of arbitration" was fully enforceable "even if the result is that arbitration will be stayed where the Act would otherwise permit it to go forward." *Id.* at 479. In reaching that holding, this Court explained that "there is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate." *Id.* at 476. By ruling that the FAA does not prevent the enforcement of agreements to arbitrate "under different rules than those set forth in the Act itself," *id.* at 478, this Court treated sections 3 and 4 of the Act as default rules, which applied only when the arbitration agreement was silent or ambiguous about a specific matter. *See also Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995) (in upholding application of choice-of-law provision contained in arbitration agreement, this Court stated that "the FAA's proarbitration policy does not operate without regard to the wishes of the contracting parties").

First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938 (1995), is also instructive. Prior to *First Options*, it was well established that the court, and not the arbitrator, normally determines the arbitrability of a particular issue under the FAA. *See Mitsubishi Motors Corp.*, 473 U.S. at 626. *See also* 9 U.S.C. § 3 (vesting the court with the authority to decide whether an issue is "referable to arbitration"). In *First Options*, however, this Court recognized that, if "clear and unmistakable" evidence existed that the parties agreed to submit the question of arbitrability to the arbitrator and not the court, then the agreement must be enforced. 514 U.S. at 944. In doing so, the Court held that the question of "'who has the primary role to decide arbitrability' turns upon what the parties agreed about *that* matter." *Id.* at 943 (emphasis in original). The conclusion that the parties' agreement controlled flowed "inexorably from the fact that arbitration is simply a matter of contract between the parties." *Id.* Thus,

this Court sanctioned the right of parties to alter by contract the respective roles of the arbitrator and the court. This Court based its ruling on the principle that the "basic purpose" of the FAA is to "ensure judicial enforcement of privately made agreements to arbitrate." *Id.* at 945 (quoting *Byrd*, 470 U.S. at 219-20).

Volt and its progeny instruct that the express provisions of the FAA are non-exclusive standards which must yield to conflicting terms contained in a private arbitration agreement unless the conflicting provisions would do "violence to the policies behind the FAA." *Id.* at 479. Nothing in sections 10 and 11 suggests that judicial review provisions are subject to any different treatment. As the Ninth Circuit originally noted in *LaPine*, "the standards against which the work of the arbitrator will be measured are inexorably intertwined with the arbitration's scope, affect its whole structure, and may even encourage the arbitrator to adhere to a high standard of decision making." 130 F.3d at 889. Accordingly, when viewed in the light of the broader context of the statute as a whole, it is clear that the vacatur and modification standards set forth in sections 10 and 11 are not intended to restrict parties' ability to contract for different standards, so long as the standards to which the parties agree do not impair the FAA's fundamental policy favoring arbitration.

In this case, the parties "clearly and unmistakably" agreed to arbitrate certain issues in their case only if the district court retained authority to review the arbitrator's conclusions for legal error. Although that stipulated standard of review differs from the vacatur standards set forth in sections 10, the parties' standard neither undermines the goals and policies of the Act nor prescribes a procedure that is inconsistent with the court's normal judicial functions. *See infra* at pp. 31-40. Accordingly, the parties' judicial review provision is entitled to enforcement.

E. The Majority of the Circuit Courts of Appeal Considering This Issue Have Interpreted the FAA's Vacatur Standards As Non-Exclusive Standards Which Parties May Supplement by Agreement

Consistent with this Court's precedents and the text and context of the FAA, a number of federal circuit courts have enforced judicial review provisions in arbitration agreements. In *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*, 64 F.3d 993 (5th Cir. 1995), for example, the Fifth Circuit determined that the FAA's statutory review provisions provided a "default standard of review" applicable to a silent arbitration agreement but that "the FAA does not prohibit parties who voluntarily agree to arbitration from providing contractually for more expansive judicial review of the award." *Id.* at 997 n. 3. Relying on this Court's case law interpreting the FAA—particularly its decisions in *Volt Info. Sciences* and *First Options*—the court in *Gateway* concluded that "federal arbitration policy demands that the court conduct its review according to the terms of the arbitration contract" because doing otherwise "would be to render the language [of the arbitration agreement] meaningless and would frustrate the mutual intent of the parties." *Id.* at 997.[4]

In *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287 (3d Cir.), *cert denied*, 534 U.S. 1020 (2001), the Third Circuit similarly described the FAA's statutory review standards as

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[4] The Fifth Circuit in *Gateway* was unimpressed with the rationale articulated by the district court judge who refused to enforce the parties' agreement on the ground that "the parties had sacrificed the simplicity, informality and expedition of arbitration on the altar of appellate review." *Id.* at 997 (internal quotation marks omitted). In finding the agreement entitled to enforcement under the FAA, the court pointed out that "[p]rudent or not, the contract expressly and unambiguously provided for review for 'errors of law'" rather than just the statutory standards for review under the FAA. *Id.*

part of the "FAA's default regime." *Id.* at 296-97. In that case, the court concluded that—just as they may opt out of other provisions under the FAA—parties may opt out of the statutory limits for judicial review of arbitration awards when they determine that it is in their best interests to do so. The First, Fourth, and Sixth Circuits also have reached those same conclusions. *See, e.g., Puerto Rico Tel. Co. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21, 31 (1st Cir 2005) ("[P]arties can by contract displace the FAA standard of review, but that displacement can be achieved only by clear contractual language."), *cert. denied,* 126 S. Ct. 1785 (2006); *Jacada Ltd. v. International Mktg. Strategies*, 401 F.3d 701, 710-12 (6th Cir.) (same), *cert. denied,* 126 S. Ct. 735 (2005); *Syncor Int'l Corp. v. McLeland*, No. 96-2261, 1997 U.S. App. LEXIS 21248, 1997 WL 452245, at *6-7 (4th Cir. August 11, 1997) (enforcing parties' expanded judicial review agreement, stating that agreement "supplements the FAA's default standard of review").[5] These cases faithfully apply the precedents of this Court and give full effect to the primary purpose of the FAA: to uphold the enforceability of arbitration agreements in accordance with their terms.[6]

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[5] The Fourth Circuit's rules provide that an unpublished case decided before January 1, 2007 may be cited if the case has "precedential value in relation to a material issue in a case and that there is no published opinion that would serve as well." (4TH CIR. LOCAL R.32.1.) There is no published opinion from the Fourth Circuit on the issue cited.

[6] Other circuits have not squarely addressed the enforceability of judicial review provisions in arbitration agreements. For example, in *Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc.*, 935 F.2d 1501, 1504-05 (7th Cir. 1991), the Seventh Circuit stated in *dicta* that the parties "cannot contract for a judicial review" of a labor arbitration award "because federal jurisdiction cannot be created by contract." *Id.* at 1505. That case did not involve an agreement to expand judicial review, did not involve the FAA and is inapposite because the FAA, unlike Section 301 of the Labor Management Relations Act, 29 U.S.C. § 185, does not create an independent basis for federal question

II. THE GOALS AND POLICIES OF THE FAA ARE NOT UNDERMINED BY ENFORCEMENT OF ARBITRATION PROVISIONS ALLOWING JUDICIAL REVIEW FOR LEGAL ERROR

Prior to its decision in *Kyocera*, the Ninth Circuit also adhered to this Court's precedents upholding the strong federal policy favoring enforcement of arbitration agreements in accordance with their terms, stating: "We perceive no sufficient reason to pay less respect to the review provision than we pay to the myriad of other agreements which the parties have been pleased to make." *LaPine*, 130 F.3d at 889.

In *Kyocera*, however, the Ninth Circuit reversed course to follow the Tenth Circuit's decision in *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925 (10th Cir. 2001). In both *Kyocera* and *Bowen*, the courts identified two grounds why the FAA did not permit judicial review provisions in arbitration awards. First, those courts expressed concerns that judicial review provisions would reduce the benefits of arbitration by making the arbitral process less efficient and streamlined and by hindering arbitrators' ability to fashion "creative remedies" that courts would be less likely to endorse. *See Bowen*, 254 F.3d at 935-36, 936 n. 7 (noting that concern); *Kyocera*, 341 F.3d at 1000 (same). Second, those courts expressed

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jurisdiction. *See Moses H. Cone Mem'l Hosp.*, 460 U.S. at 26 (so stating). The Second and Eighth Circuits also have not definitively decided the permissibility of judicial review provisions in arbitration awards. *See, e.g., Hoeft v. M.V.L. Group, Inc.*, 343 F.3d 57, 64 (2d Cir. 2003) (while taking no position on the enforceability of agreements to raise the level of judicial review of an arbitration award, the court ruled that private litigants could not completely divest the courts of authority to review the substance of the arbitration award and process under section 10 of the FAA); *UHC Mgmt. Co. v. Compute. Sciences Corp.*, 148 F.3d 992 (8th Cir. 1998) (expressing skepticism as to whether the parties could agree to expanded judicial review but choosing not to adopt the Tenth Circuit's holding in *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925 (10th Cir. 2001)).

concerns that allowing parties to contract for judicial review would compromise the integrity of the judiciary by allowing parties to dictate how courts resolve disputes, as well as potentially put "federal courts in the awkward position of reviewing proceedings conducted under potentially unfamiliar rules and procedures." *Bowen*, 254 F. 3d at 935-36; *see also Kyocera*, 341 F.3d at 1000 (noting same). As explained below, both concerns are misplaced when the standard of review at issue is review for legal error.

A. Promoting Efficiency in Arbitration Does Not Warrant Disregarding Parties' Clear and Unambiguous Agreements

Courts refusing to enforce judicial review provisions in arbitration agreements assert that judicial review of arbitration awards would undermine the efficiency and expediency of arbitration. That assertion disregards the contractual nature of arbitration. The FAA permits parties to fashion their arbitration agreements to best suit their individual needs, rather than imposing a "one-size-fits-all" approach. If parties wish to trade the efficiency and speed that may potentially result from the highly circumscribed judicial review prescribed by sections 10 and 11 for the greater predictability and adherence to the law that results from judicial review for legal error, the FAA does not preclude them from doing so. After all, enforcement of arbitration agreements in accordance with their terms is the principal purpose of the statute.

In *First Options*, this Court explained that "the basic objective in [the FAA] is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes," but rather to ensure that arbitration agreements, like other contracts, are enforced according to their terms. *First Options*, 514 U.S. at 947. In *Byrd*, this Court echoed that sentiment, explaining:

> The legislative history of the Act establishes that the purpose behind its passage was to ensure judicial en-

> forcement of privately made agreements to arbitrate. *We therefore reject the suggestion that the overriding goal of the Arbitration Act was to promote the expeditious resolution of claims.* The Act, after all, does not mandate the arbitration of all claims, but merely the enforcement—upon the motion of one of the parties—of privately negotiated arbitration agreements. . . .
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> . . . [P]assage of the Act was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered, and we must not overlook this principal objective when construing the statute, or allow the fortuitous impact of the Act on efficient dispute resolution to overshadow the underlying motivation. . . .
>
> We therefore are not persuaded by the argument that the conflict between two goals of the Arbitration Act—enforcement of private agreements and encouragement of efficient and speedy dispute resolution—must be resolved in favor of the latter in order to realize the intent of the drafters. The preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered, and that concern requires that we rigorously enforce agreements to arbitrate, even if the result is "piecemeal" litigation, at least absent a countervailing policy manifested in another federal statute.

Byrd, 470 U.S. at 219-20 (footnote omitted). *Accord Volt Info. Sciences*, 489 U.S. at 479 (enforcing arbitration agreement resulting in stay of the arbitration where express terms of FAA would otherwise permit arbitration to go forward); *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 20 (FAA "*requires* piecemeal resolution when necessary to give effect to an arbitration agreement" (emphasis in original)); *First Options*, 514 U.S. at 947 ("[T]he basic objective [of the FAA] is not to resolve disputes in the quickest manner possible * * * but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms, and accord-

ing to the intentions of the parties." (citations and internal quotations omitted)).

In this case, the intention of the parties was unmistakably clear. Neither party agreed to "trade the greater certainty of correct legal decisions by federal courts for speed and flexibility." *Kyocera*, 341 F.3d at 998. Instead, the parties agreed to arbitration in the middle of on-going federal litigation, but only with the condition that the district court would retain authority to review the arbitration award for legal error. If parties—like the parties in this case—prioritize predictability and correct decision-making over speed and "creative remedies" in arbitration decisions, the FAA allows them to do so. Refusing to respect the parties' choice "would be quite inimical to the FAA's primary purpose of ensuring that private agreements to arbitrate are enforced according to their terms." *Volt Info. Sciences*, 489 U.S. at 479. When the goals of enforcement of arbitration agreements and encouragement of efficient and speedy dispute resolution collide, this Court has consistently resolved the conflict in favor of enforcement.

B. Concerns Relating to Judicial Functioning and Integrity Are Not Implicated When Parties Seek Judicial Review for Legal Error in Arbitration Awards

Courts refusing to enforce judicial review provisions in arbitration agreements also assert that such provisions pose risks to judicial functioning and integrity. No doubt exists that parties lack authority to confer subject matter jurisdiction on federal courts, or to direct federal courts to deviate from their normal judicial functions. *See, e.g., LaPine*, 130 F.3d at 891 (Kozinski, J., concurring) (noting that parties could not direct courts to "review [an arbitration] award by flipping a coin or studying the entrails of a dead fowl"). Arbitration provisions providing for judicial review of arbitration awards for legal error, however, do not suffer from those defects.

The standard for vacatur or modification in the parties' arbitration agreement—that is, review for legal error—is a well-established standard of review that federal courts commonly employ in a variety of contexts. Federal district courts regularly review for legal error in court adjudications when litigants object to magistrate decisions, *see* FED. R. CIV. P. 72(b), or when litigants consent to the appointment of a special master, *see* FED. R. CIV. P. 53(g). District courts also undertake that type of review in the context of bankruptcy proceedings. *See, e.g.*, 28 U.S.C. § 157(c)(1). Thus, the parties' stipulation to judicial review for legal error is grounded in clear precedents in federal jurisprudence and is consistent with the courts' normal judicial functions.[7]

The parties' arbitration agreement also does not purport to ask the reviewing court to exceed the authority that the court would have in the absence of an arbitration agreement. The FAA is not a jurisdictional statute. Thus, any case before a federal district court under the FAA must have an independent jurisdictional basis. *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 25 n. 32. If the parties to this case had not entered into their arbitration agreement, the district court would have had plenary authority to adjudicate all issues in the case. By submitting a dispute to arbitration with only limited judicial review for legal error, parties lessen—not increase—the burden on federal district courts by eliminating the need for full adjudication in favor of more limited judicial review. *See LaPine*, 130 F.3d at 891 (Kozinski, J., concurring) ("[E]nforcing the arbitration agreement—even with enhanced

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[7] This Court has previously indicated its willingness to apply a judicial review standard arising out of the parties' contractual agreement. In *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 115 (1989), the Court determined that the proper standard of review for a denial of benefits under ERISA, 29 U.S.C. §1132 (a) (1) (B), was the *de novo* standard, but observed that "neither general principles of trust law, nor a concern for impartial decisionmaking, however, forecloses parties from agreeing upon a narrower standard of review."

judicial review—will consume far fewer judicial resources than if the case were given plenary adjudication."); *see also Bowen*, 254 F.3d at 936 n. 6 ("We recognize, of course, that even under expanded judicial review, arbitration reduces the burden on the district courts. . . . Reviewing an arbitration award is certainly less work than hearing the entire case pursuant to diversity or federal question jurisdiction.").

In this case in particular, there can be no claim that the parties imposed any additional burden on the court. The district court specifically approved of the parties' judicial review provision and entered the arbitration agreement as an order of the court during their ongoing litigation. Thus, the parties in no way "dictate[d] the manner in which the federal courts conduct judicial proceedings" or otherwise usurped any power reserved to Congress. *See Kyocera*, 341 F.3d at 1003. Indeed, the Ninth Circuit's refusal to enforce the parties' agreement in this case "place[d] an unwarranted limitation upon the power of district courts to control their own cases." *Cf. Moses H. Cone Mem'l Hosp.*, 460 U.S. at 31 (Rehnquist, J., dissenting). Just as a court might approve the use of a special master to facilitate resolution of a case, the district court here approved of the use of an arbitrator to achieve that same goal, reserving the court's authority to review the legal conclusions of the arbitrator just as a court would review the legal conclusions of a special master. Nothing in the FAA—nor in any other substantive law—precluded the court from retaining that authority when both parties clearly and unmistakably agreed to it.

Arbitration provisions stipulating to judicial review for legal error are enforceable even though they modify the role that the court would serve in the absence of such a stipulation. In the context of the FAA, this Court repeatedly has allowed parties to define their own arbitration procedures, even when those procedures alter the court's traditional role. For example, notwithstanding statutory provisions to the contrary,

this Court concluded that the FAA permits parties to elect to have an arbitrator—rather than the court—decide the arbitrability of a dispute. *First Options*, 514 U.S. at 943. This Court also has enforced choice-of-law provisions in arbitration agreements which allow the parties to dictate how the court interpreting an arbitration provision will function. *Volt Info. Sciences*, 489 U.S. at 478-79. Those decisions make clear that arbitration provisions are not invalid and unenforceable simply because they affect the role of the court in an arbitration proceeding.

Parties also affect the functioning of courts by private agreement in other contexts. Choice-of-forum clauses and liquidated-damages provisions, for example, both determine the functioning of the court to some degree. In addition, courts have permitted parties to waive affirmative defenses that would normally bar the court from deciding the case on the merits. In *Photopaint Technologies, LLC v. Smartlens Corp.*, 335 F.3d 152, 160 (2d Cir. 2003), for example, the Second Circuit held that the parties may agree to waive the statute of limitations for confirming an arbitration award under section 9 of the FAA. Absent the parties' stipulation, the FAA would have directed the court *not* to hear the dispute. *See also United States v. Wilson*, 26 F.3d 142, 154-56 (D.C. Cir. 1994) (discussing various cases upholding agreements to waive statutes of limitations).

In short, the mere fact that arbitration provisions providing for legal error review may alter the traditional scope of the court's review of arbitral decisions is not grounds for invalidation. Nothing in the language or policy underpinnings of the FAA precludes enforcement of judicial review provisions, so long as the stipulated procedures do not purport to confer jurisdiction where none exists and so long as the stipulated procedures are consistent with the court's normal judicial functions. Because such provisions also are consistent with the policies and goals of the FAA, provisions

stipulating to judicial review for legal error are entitled to enforcement.

C. The Federal Policies Favoring Enforcement of Private Arbitration Agreements, Efficient Resolution of Disputes and Judicial Economy Support Enforcement of the Parties' Arbitration Agreement in Accordance with Its Terms.

The FAA's strong policy favoring arbitration is well-served by allowing parties flexibility and freedom in fashioning their own arbitration procedures, including procedures allowing judicial review of arbitral decisions for legal error. Such flexibility not only reflects the contractual nature of arbitration, but also promotes arbitration and reduces the burden on the judiciary by encouraging arbitration of more complex commercial disputes.

Arbitration is a creature of contract, and parties entering into arbitration agreements have different reasons for doing so. For some parties, arbitration offers a mechanism to achieve creative solutions to a dispute. Other parties elect arbitration to keep the dispute resolution process as simple, quick, and economical as it can be. Those priorities may reflect the issues or amounts of money at stake, the frequency of disputes between the parties, or stem from any number of other reasons. For parties prioritizing efficiency and cost-effective resolution of disputes, the very limited default standards of review set forth in sections 10 and 11 of the FAA may be perfectly satisfactory and may be the scope of review which best suits their needs.

For other parties, however, the gravity of the legal issues or monetary amounts in dispute may make the parties unwilling to trade reliable decision-making and legal certainty for simplicity, expediency, and economy. In the Ninth Circuit, those parties have only two choices: litigate the dispute through court adjudication or arbitrate the dispute with no

mechanism to ensure that the arbitral result is legally correct. That stark choice undermines the attractiveness of arbitration and will drive many litigants and their attorneys to choose court adjudications over arbitration to ensure predictability and adherence to the law in the decision-making process.

This case illustrates that point. The parties already had commenced trial proceedings in court when they agreed to submit certain issues in their dispute to arbitration. The clear and unambiguous contract provision allowing judicial review for legal error was central to their agreement to arbitrate the remaining issues, and the parties would have bypassed arbitration if judicial review for legal error had been unavailable under Ninth Circuit precedents at that time. (Jt. App 52.) Arbitration was an attractive option to the parties because it allowed them to litigate the issues before the arbitrator with less onerous discovery and pretrial proceedings and to rely on the arbitrator as the fact finder (with only substantial evidence review by the court), while ensuring that the arbitrator would not reach an anomalous and incorrect legal decision which would not be subject to correction. By allowing the parties to agree to judicial review of the arbitral decision for legal error, the district court's order addressed the parties' concerns about predictability and adherence to the law, enabling them to utilize arbitration when they otherwise would have opted for full court adjudication.

The parties' priorities in this case are not unique. Particularly in complex commercial disputes, many parties may be reluctant to elect the efficiency benefits of arbitration over the guarantee of legal certainty and adherence to well-established legal principles which come from court adjudications. The FAA's policies strongly favoring arbitration are promoted—not undermined—if those parties are able to fashion arbitration procedures, including provisions allowing judicial review for legal error, to suit their individual needs.

Judicial efficiency also favors permitting parties to contract for judicial review of arbitration awards for legal error. Although it occasionally may require a more searching review than the limited grounds for vacatur under the FAA, review for only legal error certainly requires less judicial resources than full court adjudications. *See LaPine*, 130 F.3d at 891 (Kozinski, J., concurring) (so noting); *Bowen*, 254 F.3d at 936 n. 6 (same). That is particularly true for complex commercial disputes which involve multiple issues and parties, extensive discovery, and complicated facts and legal questions. By allowing courts to engage in the more limited review for legal error, judicial review provisions reduce the burden on the courts and allow courts to focus on legal issues, rather than factual disputes and issues. Such judicial review provisions also reduce the burden on the judiciary by increasing the number of parties willing to participate in arbitration, particularly in commercial disputes of monetary significance.

In short, the policy considerations uniformly cut in favor of enforcing arbitration agreements allowing judicial review for legal error. Enforcing such agreements will: (1) give effect to the contractual rights and expectations of the parties; (2) encourage arbitration by affording the parties flexibility and protection against legally erroneous awards; and (3) reduce the burden on the courts of plenary adjudication. Most importantly, giving effect to the judicial review provision in this case will further the central and pre-eminent policy of the FAA: to rigorously enforce arbitration agreements in accordance with their terms.

CONCLUSION

In this case, the parties clearly and unmistakably agreed to arbitrate a portion of the issues in their on-going federal court litigation with the condition that the district court would review the arbitration award for legal error. The district court expressly approved of the parties' arbitration agreement,

including the judicial review provisions. The FAA does not prevent enforcement of that stipulation because agreeing to judicial review of an arbitration award for legal error does not undermine the goals and policies of the statute and is consistent with the court's normal judicial functions.

For the reasons set forth above, this Court should reverse the decision of the Ninth Circuit and remand the case to the Ninth Circuit with instructions to enforce the judicial review provision in the parties' arbitration agreement.

Respectfully submitted,

MICHAEL T. GARONE *
MICHAEL A. COHEN
JAY T. WALDRON
SARA KOBAK
SCHWABE, WILLIAMSON & WYATT, P.C.
1211 SW Fifth Ave., Suites 1600-1900
Portland, OR 97204-3795
(503) 222-9981

* Counsel of Record *Counsel for Petitioner*